

ADVISORY COMMITTEE: APARTMENT RENT ORDINANCE
REGULAR MEETING ACTION MINUTES
OCTOBER 21, 2015

MEMBERS PRESENT: Matthew Carney
Gustavo Gonzalez
Joshua Howard
John Hyjer
Amiee Inglis
Roberta Moore
Melissa Morris
Elizabeth Neely
Michael Pierce
Eloise Rosenblatt
Elisha St. Laurent
Tom Scott

MEMBERS ABSENT:

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|---------------|-----------------------|------------------------|
| STAFF: | Jacky Morales-Ferrand | Housing Department |
| | Wayne Chen | Housing Department |
| | Maria Haase | Housing Department |
| | Paul Lippert | Housing Department |
| | Ramo Pinjic | Housing Department |
| | Ann Grabowski | Housing Department |
| | Shawn Spano | Contracted Facilitator |

(a) Call to Order/Orders of the Day—Shawn Spano opened the meeting at 6:16 pm.

(b) Introductions— Mr. Spano introduced himself, committee members introduced themselves, and members of the Housing Department introduced themselves.

(c) Approval of the October 7, 2015 Action Minutes

No action taken – review only

(c) Unfinished business from October 14th meeting, if any (Housing Staff, Facilitator)

There was no unfinished business.

(d) Discussion and possible action on potential modifications to the cost pass-through provisions of the ARO (Housing Staff, Facilitator)

Mr. Chen began the presentation on the cost pass-through provisions of the ARO.

Ms. Morris asked if a landlord wants to increase the rent above 8%, does the landlord have to file a petition with the City. Both the regulations and the Ordinance say “may” instead of “must”. Law Foundation experience is that the onus is on the tenant to file a petition.

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Ms. Rosenblatt asked if the reason that the pass through petitions haven't been done is because the real estate market has been flat. Most improvements are done at the time of sale.

Ms. Moore responded that she did her improvements as tenants vacated units to bring them up to standard.

Mr. Scott responded that utilizing the pass through involves a lot of paperwork and may require hiring an accountant and an attorney. Some owners may be making the decision to use the 8% or the 21% because those are easier to do and require less maintenance. Instead of Ms. Rosenblatt's example, Mr. Scott said that

Mr. Pierce said that the market constrains owners because people may not be willing to live in units if the rents are increased too high. Also the restriction of one increase per 12 months means that owners have to be strategic on when to increase rents. This is the biggest concern to owners because the market cycles. Lastly, the hearing officer has the final discretion to lower the increase.

Ms. Neely asked about the pass through process and if professional services are really warranted.

Mr. Chen responded that attorneys are not regular attendees of hearings.

Ms. Neely responded that she doesn't quite understand why an owner would choose not to follow the process if the amount of money is available.

Mr. Gonzalez responded that cost pass through provisions do not meet the standards of certainty, predictability and fairness.

Ms. St. Laurent said that she lived in her unit for five or six years during the economic downturn, but her landlord did not reduce her rent. Asked how many cases have been resolved voluntarily. Ms. St. Laurent wondered how owners can say that the process is long and difficult if they've never been through it.

Mr. Pinjic responded that not many people have used the process.

Ms. Inglis asked if all pass throughs increase the base rent in perpetuity. Even through vacancy decontrol. Asked how Santa Monica's pre-authorization work happens. From her experience other cities see more cost pass-throughs because their annual allowable increase is lower. Believes that one reason the pass through isn't being used is because the annual allowable is less effective.

Ms. Morris asked if a petition has ever been denied based on tenant hardship. Believes that San Jose isn't seeing petitions because the 8% is generous. Many business costs like mortgages and insurance are tax deductible. Because the City doesn't have a mechanism to track annual rents, it's really hard to understand what's happening in the market. Believes that cost pass-through provisions do create some fairness to both groups, as long as there are limits. Don't want to create a disincentive to properly maintain buildings. Owner hardship is also part of the petition process.

Ms. Moore said that the 8% and 21% helps a new owner improve properties that haven't been kept up or improved. What percentage of owners are English as a Second Language or small business owners? Predicted that if annual allowable is lowered, businesses will start up to help landlords use pass throughs.

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Mr. Scott agreed that if the annual allowable increase is lowered it's likely to push owners to use pass throughs. May reach a point where there becomes an incentive for an owner

Mr. Howard wondered why discussion is being had outside of the scope as directed by the City Council. Believes that there are two ways to push a rent increase: they can go through the pass through process or they can issue a rent increase over and above the 8% and be prepared to be challenged as an excessive rent increase.

Ms. Morales-Ferrand responded that the City's interpretation of the Ordinance is that the landlord must file a petition.

Mr. Howard continued that the annual allowable increase provides certainty and predictability to the owners. Ratcheting down the annual allowable increase could place a significant burden on staff and owners.

Ms. Rosenblatt asked about the demographic of owners, as many who have participated in the process are mom and pop owners and first time investors. Is there any provision in the ARO as it currently exists to determine the extent of the owner's real estate holdings?

Mr. Chen responded that it does not.

Mr. Pierce responded that cost pass-through provisions do not meet the goals of predictability, fairness or certainty.

Ms. St. Laurent said that ownership brings with it a responsibility to research the investment prior to investing. Believes the cost pass-through provisions provides predictability and fairness.

Ms. Morris said that when buyers consider buying a rental property, rents are part of the financing and purchase. Owning a rental property is a longer term investment and with that come with fluctuations in the market. Stated that there are ways to recapture costs outside of pass throughs or rent increases because many costs are tax deductible.

Ms. Inglis said that just cause evictions are related to the issue. Believes that the mediation/arbitration process is a bit long and could be reduced to just arbitration. If the annual allowable increase is reduced, it's important to have a cap on the timeframe for pass through provisions.

Mr. Scott focused on the fair return provision and said that there is no current standard for what a fair return is. The 8% provides enough income to maintain properties

Ms. Moore said it's important to remember the cycles in the market. Her business has been dependent on high-tech since 1983. When layoffs happen, the market drops. Believes that it's important to make it fair based on market cycles.

Mr. Gonzalez said that at 8% the ARO is working because Owners have enough income to take care of properties outside of the cost-pass through process and the City isn't seeing enough petitions to signify that there is a problem. Why are we focused on this?

Mr. Chen continued the presentation to review debt service petitions.

Mr. Howard asked if each of the properties are unique and also if there have been

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Ms. Moore asked how many bedrooms exist in each unit.

Mr. Scott asked if debt service occurs in the same year as other pass throughs. He also asked if the Operation & Maintenance Pass-through offered the use of variable rate interest as opposed to fixed rate interest.

Mr. Gonzalez asked about the 30 year mortgage terms. Are these 30 year fixed terms or 30 year amortization periods.

Ms. St. Laurent asked the public be respectful of during public comment.

Ms. Moore said that eliminating the debt service petitions will reduce the sale price of building which will impact the City's tax rolls.

Ms. Inglis said that she doesn't see the purpose of the debt service pass through. For tenants the rent increases tied to debt service leads to displacement.

Ms. Morris said that she agreed with Ms. Inglis. She has worked with tenants impacted by debt service cases. Specifically one case was of an owner who took out a very expensive loan and passed costs along to the tenant. Displacement happens.

Ms. Rosenblatt is sympathetic to the investment process. There are many ways to disguise costs as debt.

Mr. Pierce said that the purpose of the debt service pass through is for owners to be able to recoup their costs and spread them over time (tenants). Removing the debt service provision will have an impact on sales and probably will reduce property maintenance.

Mr. Howard said that without this provision the property owner may go into foreclosure. Having a mechanism in place to pass on costs provides a financial benefit to the City and the County in property tax increment.

Ms. Morales-Ferrand asked for Mr. Howard to clarify the argument that foreclosure scenario is likely without debt-service.

Ms. Morris stated that she doesn't understand why the existence or non-improvement pass through would determine whether or not a property could be managed. If capital improvements are necessary, there is a cost-pass through provision for that.

Mr. Pierce said that without the pass through the land value would decrease as would assessed values and sales would also drop. If deals were done recently changes to the Ordinance could negatively impact them.

Mr. Carney said that 8% is only working on the part of the owners because it provides them enough profit. This discussion is happening because displacement is happening. Many people don't know that they live in an ARO apartment, which may be artificially reducing petitions.

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Ms. Neely said that if the rent increase is within 8% a tenant can't petition regardless of a person's ability to pay.

Mr. Gonzalez said that he isn't seeing displacement because he actively works to keep his tenants. Because only .4% of tenants have complained, there can't be a problem. Believes that displacement is happening in market rate units. Believes that education is necessary and the City should directly contact tenants to let them know.

Mr. Carney said that many people aren't able to file petitions because the current rate is allowable but is too high. Displacement is happening.

Mr. Scott said that it's hard to discuss these topics separately because all topics are interrelated. Is concerned that the outcomes of other cities haven't been provided. No rent control is the best outcome. San Jose is less bad than other cities. Does not agree that San Jose should gravitate toward the positions of other cities. Rent control provides a disincentive to investment.

Mr. Howard said that we should be considering how to make the debt service provision work for both owners and tenants. Perhaps the pass through should be amended to take into account the lending market's economic restrictions. 65% rent increases is high. The debt service provision can work for all parties.

Mr. Gonzalez said that number of total inquiries still doesn't constitute an issue.

Ms. Moore said that many people don't know that they're buying an ARO property.

Ms. Inglis said that debt service should be eliminated. It's improper to pass the risk of ownership on to tenants for uninformed business decisions. Other provisions of the ordinance provide a fair and reasonable return but the debt service provision is not an appropriate avenue. Many corporate landlords who purchased properties during the foreclosure crisis are offering subprime "landlord loans".

Ms. Morris said that the provision does not prohibit excessive rent increases. The debt service pass through should be eliminated.

Ms. Rosenblatt said that when people feel powerless they don't speak up. The number of client interactions or petitions with RRRP is not indicative of there not being a problem.

Mr. Howard asked if the committee should be offering specific recommendations and when that would take place.

Mr. Chen responded that the committee will have an opportunity to

Ms. Morales-Ferrand noted that this topic will be referred to the next meeting for specific changes to the debt service pass through. Other questions and data requests will be provided as well.

Ms. Moore said that she would like to know how many bedrooms were in each other unit.

14 Members of the public provided public comment on this item.

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Temperature check question – deferred to 10/28/15 meeting

(e) Open Forum

22 members of the public provided public comment on this item.

(f) Adjourn Facilitator Shawn Spano adjourned the meeting at 8:52 pm.